MACHAKOS UNIVERSITY COLLEGE

(A Constituent College of Kenyatta University)
University Examinations for 2015/2016 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BUSINESS ENTREPRENEURSHIP AND MANAGEMENT SCIENCES

SECOND SEMESTER EXAMINATION FOR DEGREE IN BACHELOR OF COMMERCE

BAC 414: REAL ESTATE FINANCE.

Date: 10/8/2016 **Time: 11.00-1.00 AM**

INSTRUCTIONS

Answer Question One and any Other Two Questions

QUESTION ONE (30 MARKS)

a) Explain the meaning of the following terms as used in Real Estate Finance: (3 marks)

- i) Estate in possession.
- ii) Estate not in possession.
- iii) Life Estate.

b) Explain for what purpose buyers insist on title assurance. (2 marks)

c) i) X Corporation is evaluating an investment that will provide the following returns at the end of each of the following years:

Year	Sh.
1	9,000
2	6,000
3	4,000
4	8,000
5	(500)

The corporation believes that it should earn an annual interest of 15% on its investments. How much should it pay for this investment? (5 marks)

ii) An investor pays Sh.2,000 per month into a real estate investment which promises to pay an annual rate of interest of 10% compounded monthly. If he makes consecutive monthly payments for five years, how much will the amount accumulate to after that period? (3 marks)

iii) Assuming that an individual is considering an investment which will provide a series of annual cash receipts of Sh. 50,000 for a period of 5years and that the desired rate is 5%, for the investment to be viable, how much should he source for? (3 marks)

iv) Rogers is considering the purchase of a lot. He can buy it today and expects the price to increase to sh.250,000 after six years. He believes that he should earn an investment yield of 10% annually on this investment. The asking price for the lot is Sh.110,000. Should he buy it? (4 marks)

d) Mr. brown made a 30 year mortgage loan five years ago for Sh.300,000 at nine percent interest per annum . He now wants to pay down the mortgage balance by Sh.50,000. (10 marks)

i) Assuming that he pays down the balance, what would be the new monthly repayment for the remaining period?

ii) Assuming the loan maturity is shortened, what will the new loan maturity be?

QUESTION TWO (20 MARKS)

a) Briefly explain the various methods of mortgage adjustments. (6 marks)

b) Explain the factors to be considered when deciding whether to refinance a loan after interest rates have declined. (6 marks)

c) A potential homeowner has Sh.30,000 to invest in a Sh.140,000 home. He can obtain either a Sh.110,000 loan at 11% for 20 years or a Sh.90,000 loan at 10% for 20 years and a second mortgage of Sh.20,000 at 14% for 20 years.

Which alternative should he choose, assuming he will be in the house for the whole loan term. (8 marks)

QUESTION THREE (20 MARKS)

a) Many mortgages do provide explicitly that a penalty can be paid by the borrower should he decide to prepay the loan. Explain the rationale for the penalty. (4 marks)

b) A borrower is faced with choosing between two loans. Loan A, is available for Sh.100,000 at 12% interest per annum for 30 years, with a 1% to be included in closing costs. Loan B, would be made for the same amount, but for 11.5% interest per annum for 25 years, with 3% to be included in the closing costs: (16 marks)

i) If the loan is repaid after three years, which loan would be a better choice?

ii) If it is repaid after five years, which loan would be a better choice?

QUESTION FOUR (20 MARKS)

a) What are the risks associated with investing in real estate? In what ways are they similar to the risks associated with investments in financial assets? (6 marks)

b) James wants to buy a property for Sh.90,000 and wants an 80 percent loan of the value of the property. A lender indicates that the loan can be obtained for 25 years at 13 percent interest. However, a loan origination fee of Sh.1,500 will also be necessary for James to obtain the loan. (14 marks)

i) How much will the lender actually disburse?

ii) What is the effective interest cost to the borrower, assuming that the mortgage is paid off after 25 years (full time)?

iii) If he pays off the loan after five years, what is the effective interest charge? Why is it different from (ii) above?

QUESTION FIVE (20 MARKS)

a) In real estate finance there are several general methodologies for determining value. Briefly explain them. (4 marks)

b) A mortgage loan for Sh.500,000 was to be paid in a period of 30years at an interest rate of 12% compounded annually. (16 marks)

i) Determine the closing balance of the loan after 5years.

ii) Now that prevailing interest rates have gone down to 10% in another financial institution, determine how much a borrower should look for to ensure early repayment of the mortgage after five years.

iii) Assuming that the amount in (ii) above, is a loan to be repaid in equal monthly amounts for a period of 15years, determine first repayment and the closing balance after two months.